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DEPARTMENT OF STATE REVENUE

LETTER OF FINDINGS NUMBER: 97-0545 ST
Sales/Use Tax — Vehicle Lease Transactions
For Tax Periods: 1994 through 1996

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ISSUES

I. Sales/Use Tax — Vehicle Lease Transactions

Authority: IC 6-2.5-1-5; IC 6-2.5-1-6(a); IC 6-8.1-3-3.5; IC 4-22-2-24; IC 6-2.5-5-38.2
45 IAC 2.2-4-27(c); 45 IAC 2.2-1-1(j)
Information Bulletin #28

Taxpayer protests the assessment of Indiana sales tax on the trade-in allowances given to its customers in lease transactions.

STATEMENT OF FACTS

Taxpayer, an automobile dealership, sells and services new and used automobiles. Taxpayer also negotiates automobile leases with its customers. Audit and taxpayer are in disagreement as to the amount of sales tax that should have been collected by taxpayer in its vehicle leasing arrangements.

I. Sales/Use Tax — Vehicle Lease Transactions

DISCUSSION

As part of its automotive leasing business, taxpayer negotiates lease agreements with its customers. In arriving at the selling price of a leased vehicle, the final cost to the customer is partially offset by any capital cost reductions (down payments). These down payments usually represent cash tendered, manufacture's rebates, and any trade-in allowances. Taxpayer collected

sales tax on the cash tendered and on the value of the manufacturer's rebates. Taxpayer, however, did not collect sales tax on the trade-in allowances.

Audit has concluded that taxpayer should have collected and remitted sales tax on the trade-in allowances. Audit relies on 45 IAC 2.2-4-27(c) which states that "the gross receipts from renting or leasing tangible personal property are subject to tax." Audit reasons that since the trade-in value of the customer's vehicle was consideration given to the taxpayer, and was included in the down payment on the lease agreement, the trade-in allowance was subject to Indiana's gross retail tax (sales tax).

Taxpayer has disagreed with Audit's proposed assessments and advances three arguments in support of its protest.

(1) Like kind exchanges

Taxpayer asserts that since trade-in allowances are exempt from sales tax in *purchase transactions* - as like kind exchanges - trade-in allowances should also be exempt in *lease transactions*. From taxpayer's perspective, there are no substantive differences between a lease and purchase that would effect the method of taxing down payments.

Taxpayer indicates that it has relied on Information Bulletin #28, *Sales/Use Tax: Motor Vehicle Sales and Repairs,* for guidance regarding the taxation of trade-in allowances. Specifically, taxpayer refers to the following language:

> [T]he selling price upon which the tax will be based will be the actual consideration tendered for the vehicle *after deducting all appropriate discounts and trade-in allowance*. The deduction for trade-in allowance applies only to vehicles traded in, and does not apply to other property either personal or real, which is traded for a vehicle. (Emphasis added).

Taxpayer notes that this treatment is consistent with the generally accepted practice of treating exchanges of like kind properties as non-taxable transactions. As an illustration of this proposition, taxpayer alludes to Rule 45 IAC 2.2-1-1(j), which states:

> Non-taxability extends only to the amount of value of the [like kind] property received. Any additional consideration, commonly know as "boot" received either in cash or property of unlike kind must be reported for taxation at actual value. However, when any property is clearly used as a medium of exchange in lieu of cash, the element of taxable exchange will be present.

Taxpayer points out that prior to July 1, 1997, there did not exist any statutory or regulatory language explaining the concept of like kind exchange as it applied to vehicle transactions. This lack of explanatory language led taxpayer to believe that its interpretation of the like kind exchange concept was consistent with Indiana law.

In support of its interpretation, taxpayer introduces the case, *Century Electric Co., v. Commissioner of Internal Revenue*, 192 F.2d 155 (8th Cir. 1951). *Century Electric* concerned the sale of real property that was subject to a lease-back provision. The Century Electric Company sold its manufacturing real estate, at a loss, and then leased the property back for a period of ninety-five (95) years. Century Electric deducted the loss. The Internal Revenue Service (IRS) disallowed the deduction contending that the transaction was really an exchange of like kind property. In upholding the IRS's decision, the court agreed with Treasury's interpretation that "a lease with thirty (30) years or more to run and real estate are properties of 'like kind.'" *Id*. at 160. Taxpayer concludes by stating that "the exchange of an owned vehicle for a leased vehicle is identical [to the exchange discussed in *Century Electric*] and should be treated as a like kind exchange."

As taxpayer indicates, the value received in a like kind exchange is not considered to be gross retail income. Consequently, such income is not subject to Indiana gross retail tax (sales tax). As Indiana Code § 6-2.5-1-5 instructs:

> "Gross retail income" means the total gross receipts, of any kind or character, received in a retail transaction, *except* that part of the gross receipts attributable to:
>
> (1) the value of any tangible personal property received in a like kind exchange in the retail transaction;

However, for taxpayer's lease transactions, the trade-in of an owned vehicle for a leased vehicle does not meet the statutory definition of a like kind exchange. A like kind exchange is defined in Indiana Code § 6-2.5-1-6(a) in the following manner:

> "Like kind exchange" means the reciprocal exchange of personal property between two (2) persons, when:
>
> (1) the property exchanged is of the same kind or character, regardless of grade or quality; and
>
> (2) the persons exchanging the property both own the property prior to the exchange.

The trade-ins involved in these lease transactions were not exchanges of property of the "same kind or character." The customer's vehicle trade-in (tangible personal property) was not exchanged for ownership in another vehicle. Rather, it was exchanged for *the lease* of a vehicle owned by another (intangible personal property). Furthermore, the bundle of rights acquired in a lease transaction is not equivalent to that acquired in a purchase agreement. Consequently, the property exchanged is not of the same kind or character.

Taxpayer has also argued that the holding in *Century Electric* requires the Department to find that taxpayer's transactions qualify as like kind exchanges. However, the Department does not find the facts of *Century Electric* to be analogous to taxpayer's situation and consequently, does not find the holding to be persuasive. In fact, the finding that a lease of greater than thirty (30)

years is equivalent to a purchase of real property lends support to the proposition that under normal circumstances, such a transaction *would not* be characterized as a like kind exchange.

(2) Insufficient Notification

Taxpayer argues that since the Department had two different positions regarding the taxation of trade-in allowances, the Department was required to communicate those differences to the public. Taxpayer admits that without proper notice, it was caught unaware of the Department's position in favor of the taxation of trade-in allowances in lease transactions. Since taxpayer believed that trade-in allowances would be treated the same in all types of vehicle transactions, taxpayer never modified its method of computing sales tax and never collected the tax.

The Department recognizes that during the audit period, leasing had become one of the preferred methods for consumers to acquire the use of new vehicles. While similar to a purchase in that consumers still received the use of a new vehicle, and still made monthly payments - the method of acquisition represented a different type of transaction. As a consequence, the characterization of the property received by the customer changed - from complete ownership, to a more limited right of possession and use. The purchase transaction had become a lease.

As discussed in 45 IAC 2.2-4-27(c):

> In general, the gross receipts from renting or leasing tangible personal property are subject to tax. The rental or leasing of tangible personal property constitutes a retail transaction, and every lessor is a retail merchant with respect to such transactions. The lessor must collect and remit the gross retail tax or use tax on the amount of actual receipts as agent for the state of Indiana.

The transactions at issue involved the lease of tangible personal property. Taxpayer characterized the transactions as leases. Consumers treated the transactions as leases. So did the Department.

The Department was not required to issue public notice regarding the taxation of vehicle trade-in allowances. Public notice is required when the Department intends to promulgate new rules (IC 4-22-2-24) or when the Department issues information bulletins, revenue rulings, letters of finding, or other kinds of guidelines (IC 6-8.1-3-3.5). In this instance, the Department neither promulgated new rules nor changed its interpretation of any existing rules or statutes. The Department's treatment of consideration given in a lease transaction has never changed. The lease of a vehicle was governed by an existing rule, 45 IAC 2.2-4-27(c) - a rule that the Department has consistently applied to the lease of all types of tangible personal property.

(3) New Statute

Taxpayer claims that a new statute - effective July 1, 1997 - was our legislature's response to the Department's misapplication of its like kind exchange regulation. This newly enacted statute explicitly exempts from sales tax the value of vehicles exchanged (traded-in) in lease

transactions. Taxpayer directs the Department's attention to Indiana Code § 6-2.5-5-38.2, which states:

> The value of an owned vehicle is exempt from the Indiana gross retail tax in a vehicle lease transaction if the owned vehicle is exchanged for a like kind vehicle.

Taxpayer argues that this new statutory language should preclude the Department from enforcing Audit's erroneous assessment of Indiana sales tax on the trade-in of vehicles in lease transactions.

The Department notes that absent language stating otherwise, statutes are given prospective treatment. In this instance, the wording of Public Law 253 Section 38 - the law in which Ind. Code § 6-2.5-5-38.2 was enacted - explicitly states that this new section was to take effect on July 1, 1997. The statute, therefore, can not be applied retroactively. Since taxpayer's audit period ended prior to the effective date of the new statute, taxpayer cannot take advantage of the statute's provisions.

FINDING

Taxpayer’s protest is denied.